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SUBJECT: SLOVAKIA AMONG WORLD'S FASTEST GROWING ECONOMIES

¶1. SUMMARY: Slovakia's economy rose by a record 9.8 percent year-on-year during the third quarter, up from 6.7 percent in the previous three months, the Statistical Office reported. The growth at one of the fastest rates worldwide was driven mainly by consumer goods and investments. Robust economic performance may prompt the central bank to tighten its monetary policy further to trim down potential inflationary pressures. The crown's recent strengthening has so far prevented an increase in shop prices, but possible corrections and/or rising household consumption could pose a risk for price stability in the upcoming months. END SUMMARY.

¶2. Slovakia's gross domestic product (GDP) rose by a real annual 9.8 percent in the third quarter, to SKK 424.9 billion (in fixed prices), beating all market forecasts by several percentage points. The average growth in the first three quarters represents 7.8 percent year-on-year. The Statistical Office also said it had revised its full-year GDP growth forecast to 7.7 percent, from a previously expected 6.5 percent. Slovakia has had the highest growth rates among the four largest EU newcomers from central Europe over the past few years, but the third quarter figure brought it to the ranks of the world's fastest growing economies.

¶3. The key drivers of the Slovak economy were investments, shown in inventories, and domestic private demand. The gross capital formation, i.e. corporate investment and change in inventories, rose by an extraordinary 19.3 percent annualized rate during the third quarter, the majority of which was result of unusually high stocks. The breakdown of the data showed stock accumulation primarily in the manufacturing industry, which indicates that a big portion of stocks should transform into exports, providing the impetus for more growth in the future. Another part of inventories came from one-time purchases of strategic commodities, and the rest lies with Christmas season pre-stocking in the retail sector.

¶4. Domestic demand kept its solid pace, with household consumption rising at an above-forecast 6.5 percent from July to September, while public spending gained 1.2 percent on the year. The contribution of net trade also remained positive, as export growth again outpaced imports 23.8 percent vs. 22.9 percent year-on-year for the reported period. This component should gain more importance in months to come as carmakers PSA Peugeot and Kia gradually boost their production and consequently improve Slovakia's export bill.

¶5. According to the Statistical Office (using data based on random telephone surveys), Slovakia's unemployment rate dropped 2.8 percentage points year-on-year in the third quarter, to 12.8 percent, the lowest rate since the last quarter of 1998. The overall number of jobless declined by 73,400, or 17.7 percent, to 341,600. (NOTE: Statistics provided by the Ministry of Labor, which are more in line with the U.S. methodology focusing on those actively seeking employment, indicated that unemployment on a seasonally adjusted base dropped to 9.8 percent in October, the new low since 1993). This was mainly a result of continuing domestic job creation and an

outflow of Slovaks to the EU. Employment picked up 3.8 percent in the reported period after growing by 4.5 percent in the previous three months. The number of Slovaks working abroad increased by more than 30,000 from a year ago, to approximately 166,000 at the end of September 2006. Prospects for strong employment growth remain positive on incoming FDI and improving purchasing power, which could result in more jobs in the service sector.

¶6. The average nominal monthly salary in the Slovak economy reached SKK 18,212 (USD 680) at the end of the third quarter, up 7.7 percent from a year ago. On the back of higher inflation, the real average wage growth slowed to 2.7 percent year-on-year in the third quarter, from 4.0 percent in the previous three months. The pace of pay increases still seems to be covered by productivity growth. The Statistics Office expects the average salary for 2006 to be 7.8 percent higher than in 2005.

¶7. COMMENT: The GDP structure sent mixed signals to the policy makers at the central bank. The bank has raised its key two-week rate by 175 basis points this year, to 4.75 percent, because inflation risks from high energy prices and economic growth could endanger the goal of adopting the Euro in 2009. (NOTE: The consumer prices inflation recorded a 20-month high in August at an annual 5.1 percent). But a crown appreciation by over 5 percent in the past three months has since limited shop price growth, allowing the bank to keep rates on hold for the second month in a row in November. Nevertheless, as November inflation accelerated to 4.3 percent Year-on-Year (after the 3.7 percent YoY in October) and domestic consumption remained high, the bank will probably remain very cautious. Analysts rejected the immediate need to raise interest rates further, but admitted that more tightening may be needed in the coming months, largely depending on currency development and its eventual corrections. END COMMENT.

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